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International Economic & Energy Weekly

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Perspective

World Grain Trade: Implications of a Changing Market

Export drives by major competitors in the world grain market will produce problems for US interests on two fronts over the rest of the decade. First, Soviet dependence on US grain is likely to continue to diminish. Major US competitors can now supply Moscow with 25 million tons of grain annually and will be capable of supplying more by the late 1980s. Indeed, Moscow—the major buyer in a depressed grain market—will gain as all suppliers are forced to compete for Soviet grain business. 25X1

Although the competitive advantage the United States holds in the production and export of coarse grains such as corn is likely to continue, US farmers will face stiffer competition in the world grain markets for the remainder of the decade. In fact, we see a prospect of no US grain export growth through 1990 unless competitor marketing strategies are offset. Our analysis indicates that the US share of the world wheat market could plummet from its high of 49 percent just three years ago to 30 percent in 1985/86 and as low as 25 percent by 1990 25X1

A key factor in these shifts in the world grain market are foreign governments' policies to increase their share of the grain export market. This element is more important, in our view, than the rapid appreciation of the dollar. Each major competitor has under way export expansion programs, relying heavily on price cutting, credit subsidies, artificially low transportation rates and hidden bonuses. By 1990, 25X1

- Canada plans to increase grain exports by 25 percent.
- Australia plans to boost grain exports by one-third.
- Argentina plans to nearly double grain exports.

The European Community is continuing its aggressive policy to market its rising exportable surpluses and will reportedly no longer adhere to its self-imposed limit of 14 percent of the global grain market. 25X1

Barring major crop disasters, other factors at play also assure a buyers' market and heightened competition through the rest of the 1980s. Developed-country grain markets are saturated; import demand has not increased since the mid-1970s. Meanwhile, policy reforms and sustained technological improvements are reducing grain import demand in China, India, and the European Community. The LDCs are the only major group of countries likely to increase their demand for grain in the near term. With the debt problems faced by many of these countries, however, concessionary terms will be a determining factor in closing a deal.

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We believe political tensions between the United States and its allies could worsen as a result of slow growth in world grain markets. Relations with Canada and Australia may be tested by US export programs, and, although the EC reportedly wants to avoid a trade war, it is unlikely to back away from its aggressive tactics in traditional US markets. With a record stock buildup this year, the EC may even attempt to match some US grain export initiatives. [redacted] 25X1

[redacted] 25X1

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Eastern Europe's Trade: Short-Lived Gains in 1984

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Eastern Europe in 1984 posted its most favorable trade performance in several years. A pickup in hard currency sales enabled the region to improve its financial position with the West and to relax some import restraints imposed during the 1981-83 financial crisis. Despite Moscow's tough-sounding demands, Soviet support through trade increased slightly for the first time in three years. Poor first-quarter results in hard currency trade this year and Soviet insistence on reducing deficits, however, will cause 1985 trade performance to fall short of last year's favorable results. In formulating trade strategies for 1986-90, economic planners will find it difficult to balance requirements for Western imports, debt service obligations, and growing Soviet demands for more resources.

Recovery of Hard Currency Exports

The recovery of Eastern Europe's exports to the West gathered strength in 1984. Following a decline in 1981-82 and negligible growth in 1983, hard currency sales in dollar terms rose 7 percent last year.[1] Romania's export-at-all-cost policy to reduce its debt produced a 17-percent increase in deliveries, the largest gain in the region. Eastern Europe's other troubled debtors—Poland and Yugoslavia—boosted exports by nearly 10 percent as Warsaw stepped up coal sales during the British miners strike, and IMF-supported devaluations enhanced Yugoslav export competitiveness. Among the other countries, only Bulgaria enjoyed strong export growth, relying on sales to LDCs to compensate for a decline in exports to the developed West. Hungary, whose agricultural exports were hit by weak prices, posted little growth while East Germany apparently directed exports toward West Germany at the expense of other Western markets in order to reduce its bilateral debt to Bonn.

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Energy products led the growth in sales to the West, but exports of manufactures languished. Poland and Romania scored the largest gains in exports of energy. Polish coal exports reached nearly 30 million metric tons, a 44-percent increase over 1983, yielding hard currency earnings of $1.3 billion. Coal mining was strained to capacity, and stocks that had been built up during mild winters in 1982/83 and 1983/84 were sold off. Romanian exports of oil and petroleum products rose to $2.6 billion from $2.0 billion the previous year. Sales of semimanufactured goods such as steel products picked up, but machinery exports failed to recover from the precipitous drops of 1981-82. Poland accounted for much of the fall because of production problems in its manufacturing industry. Czechoslovakia's aging industrial base—partly the result of the regime's cautious policy on importing Western equipment—underlies its deteriorating competitiveness in machinery markets. Only East Germany can claim any success in raising machinery sales to developed countries.

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Modest Increase in Hard Currency Imports

The growth in exports and increased availability of trade financing allowed Eastern Europe to ease import restraints imposed in 1981-83, but purchases from the West remain well below the 1980 peak. Romania and East Germany accounted for most of the pickup in hard currency imports. Financial pressures limited the increases in Polish and Yugoslav purchases, while Bulgaria and

[1] East European trade performance was even stronger when allowance is made for the appreciation of the dollar against other Western currencies. We estimate that average East European export prices declined by 6 to 7 percent, while average import prices declined by 4 to 5 percent. Volume growth of East European trade flows exceeded reported growth in dollars by at least these amounts.

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Eastern Europe: Hard Currency Trade [a]

Million US $

	1983	1984 [b]
EE Exports	37,494	40,198
Bulgaria	2,879	3,161
Czechoslovakia	4,142	4,304
East Germany	7,930	8,075
Hungary	4,848	4,965
Poland	5,402	5,828
Romania	6,246	7,277
Yugoslavia	6,047	6,588
EE Imports	32,974	33,820
Bulgaria	2,415	2,475
Czechoslovakia	3,371	3,472
East Germany	6,606	7,018
Hungary	3,970	3,729
Poland	4,317	4,372
Romania	4,558	4,995
Yugoslavia	7,737	7,759
EE Balance	4,521	6,378
Bulgaria	464	686
Czechoslovakia	771	832
East Germany	1,324	1,057
Hungary	878	1,236
Poland	1,085	1,456
Romania	1,688	2,282
Yugoslavia	−1,690	−1,171

[a] Includes intra-CEMA hard currency trade.
[b] Preliminary.

Source: Official East European data, Western creditor reports.

Czechoslovakia continued to give higher priority to trade surpluses. Only Hungary reduced imports for the third consecutive year despite lifting import controls in accordance with its IMF standby program.

Most of the increase in imports went to raw materials, chemicals, and semimanufactures to rebuild stocks and support the pickup in industrial production throughout the region. Imports of machinery and equipment, however, declined for the fifth year in a row. The adjustment policies adopted by the East European countries have relied on paring purchases of Western capital goods, cuts that have the least impact on short-term economic performance. With the exception of Romania, most regimes have been wary about cutting purchases of consumer goods and foodstuffs. Last year's bumper harvest, however, enabled the region—particularly Poland—to reduce grain imports, freeing up resources for other purposes. 25X1

Improved Financial Position

With export gains outpacing the increase in imports, Eastern Europe pushed its hard currency trade surplus to a record $6.3 billion, a 40-percent improvement over the 1983 surplus and a dramatic reversal of the peak $11.0 billion deficit recorded in 1979. Only East Germany suffered a deterioration of nearly $270 million in its balance of trade with the West. A healthy trade surplus helped boost the region's current account surpluses for a second year, which enabled Eastern Europe to rebuild foreign exchange holdings by nearly $4 billion and reduce net hard currency debt by $4.4 billion. This has restored the confidence of Western lenders, resulting in new credit offers to East Germany, Hungary, Bulgaria, and Czechoslovakia. 25X1

Trade With the USSR

Eastern Europe's trade deficit with the USSR—a key element of Soviet economic support for the region—rose from 1.6 billion rubles ($2.2 billion) in 1983 to 1.9 billion rubles ($2.3 billion) last year.[2] This reversed a two-year decline in the deficit and ran contrary to Soviet rhetoric at high-level CEMA meetings in 1983 and 1984. The growth of East

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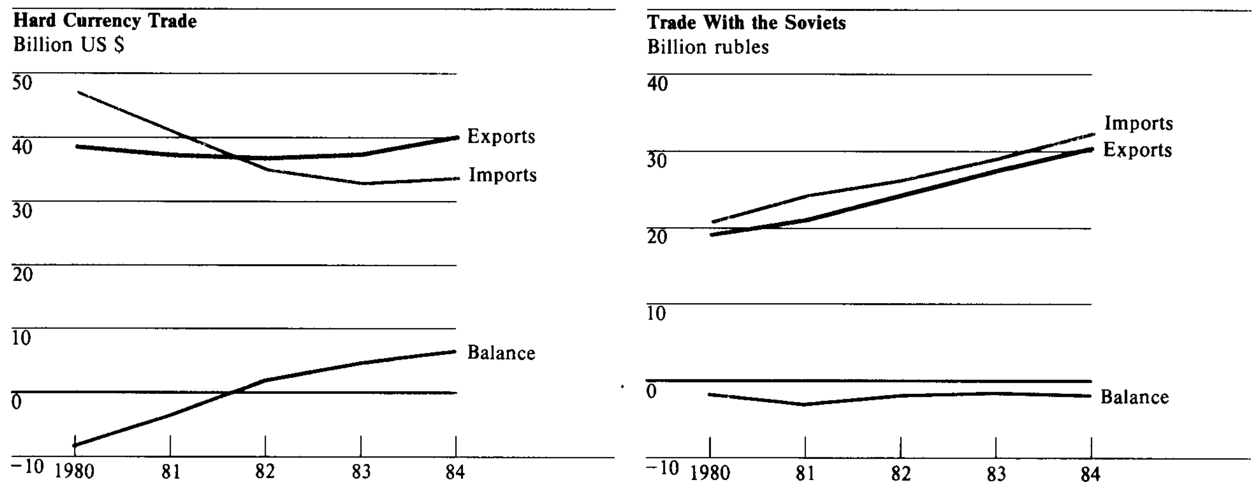
[2] Discussion of Soviet trade with Eastern Europe excludes Yugoslavia because this trade is conducted on a different basis than Soviet trade with CEMA countries. 25X1

Eastern Europe: Foreign Trade, 1980-84



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European deliveries slowed from 13 percent in 1983 to 11 percent, while imports from the Soviets grew by 11 percent. When the impact of rising Soviet energy prices is filtered out, Eastern Europe probably received its first—albeit small—increase in real imports from the Soviets since 1980.

Poland, Czechoslovakia, and Bulgaria accounted for the larger overall trade deficit with the USSR in 1984:

- Poland's deficit increased by nearly 300 million rubles ($370 billion) as the USSR provided above-plan deliveries of oil, wheat, and tea, while Polish exports slacked off from the rapid pace set in 1983.

- Czechoslovakia increased its trade deficit for the fourth consecutive year. A substantial part of this deficit may result from the growing volume of gas deliveries Czechoslovakia receives as payment for transporting Soviet gas to the West.

- After cutting its deficit in 1983, Bulgaria's trade gap rose last year as export growth fell from nearly 18 percent to 11 percent.

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Apparently responding to Moscow's call for balanced trade, East Germany pared its deficit by nearly half to 114 million rubles ($140 million), and Hungary moved from a 51-million-ruble ($70 million) deficit to a 114-million-ruble ($140 million) surplus. Romania continued to maintain trade near balance.

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Outlook

Eastern Europe is unlikely to repeat last year's favorable trade performance in 1985. Exceptionally harsh winter weather caused transportation breakdowns, energy shortages, and declines in industrial

Eastern Europe:
Hard Currency Debt at Yearend

Billion US $

	1983	1984 [a]
Bulgaria		
Gross Debt	2.4	2.3
Net Debt	1.3	0.9
Reserves	1.1	1.3
Czechoslovakia		
Gross Debt	3.9	3.6
Net Debt	3.0	2.5
Reserves	0.9	1.1
East Germany		
Gross Debt	12.8	12.7
Net Debt	9.1	7.7
Reserves	3.4	5.0
Hungary		
Gross Debt	8.3	8.3
Net Debt	6.7	6.1
Reserves	1.6	2.1
Poland		
Gross Debt	26.4	28.2
Net Debt	25.3	26.4
Reserves	1.2	1.8
Romania		
Gross Debt	9.0	7.5
Net Debt	8.5	6.8
Reserves	0.5	0.7
Yugoslavia		
Gross Debt	19.0	18.6
Net Debt	17.4	16.4
Reserves	1.6	2.2
Total		
Gross Debt	**81.8**	**81.0**
Net Debt	**71.3**	**66.9**
Reserves	**10.2**	**14.1**

[a] Preliminary.

Sources: Data from Bank for International Settlements, NATO, Berne Union of Credit Insurers, and CIA estimates.

Eastern Europe:
Trade With the USSR

Million rubles [a]

	1983	1984
EE Imports	29,152.1	32,393.8
Bulgaria	5,510.8	6,124.4
Czechoslovakia	5,871.6	6,590.8
East Germany	6,797.8	7,481.4
Hungary	4,058.0	4,320.8
Poland	5,274.3	6,069.2
Romania	1,639.6	1,807.2
EE Exports	27,528.4	30,478.1
Bulgaria	5,053.3	5,608.0
Czechoslovakia	5,420.4	6,016.5
East Germany	6,595.7	7,367.2
Hungary	4,007.0	4,434.4
Poland	4,786.7	5,296.8
Romania	1,665.3	1,755.2
EE Balance	−1,623.7	−1,915.7
Bulgaria	−457.5	−516.4
Czechoslovakia	−451.2	−574.3
East Germany	−202.1	−114.2
Hungary	−51.0	113.6
Poland	−487.6	−772.4
Romania	25.7	−52.0

[a] One ruble equals $1.348 for 1983 and $1.227 for 1984.

Source: Soviet foreign trade statistics.

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output. Hard currency trade performance has suffered as a result of lower exports and the need to increase purchases of energy. Although the region may recoup some of the trade losses, it is unlikely to run another record surplus and at the same time raise imports. Romania already has needed emergency financial help from Western banks to cover an installment on its 1982 rescheduling agreement; Bucharest has adopted a crash program to boost exports and restrain imports in the hope of meeting future obligations. Poland also has cut back on import plans in order to net a planned hard currency trade surplus of $1.5 billion. The more solvent countries have greater flexibility to opt for smaller surpluses and less restraint on imports. 25X1

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The Soviets apparently have insisted on stricter compliance with their trade demands this year. Trade protocols for 1985 between the USSR and nearly all East European countries call for balanced trade; Soviet credits that finance Warsaw's trade deficit were lowered by 35 percent to 500 million rubles ($600 million). Although the Soviets may relent somewhat in view of the region's shaky economic start, we doubt that the USSR—also afflicted by a harsh winter—will accept many excuses from Eastern Europe for failure to meet trade commitments. With oil output falling and other raw materials becoming costlier to produce, the Soviets will probably be less willing to maintain deliveries without receiving more from Eastern Europe.

The East Europeans face difficult decisions in developing their trade strategies for the 1986-90 plan period. Even though Western imports have not proved a panacea, the regimes—to varying degrees—still see trade with the West as important for modernization and improved economic performance. Nonetheless, the regimes as well as Western lenders are wary about repeating the experience of the 1970s that led to excessive debt and painful adjustment in the 1980s. The USSR has warned its allies about the need for caution in economic relations with the West.

The policy decision is likely to be holding the line—if not further reductions—in hard currency debt over the medium term. Romania and Czechoslovakia continue giving priority to debt repayment over imports; Poland and Yugoslavia, which face more years of debt rescheduling, have little choice but to put export growth and debt servicing ahead of imports. Other countries may have more room to maneuver but are unlikely to let the growth of Western imports outpace hard currency exports. With little potential for achieving sustained and strong growth of exports, the region will have to limit its plans for Western purchases.

The East Europeans must also heed Moscow's warnings about the need to commit more resources to Soviet economic goals. In negotiations on 1986-90 trade plans, the Soviets apparently are pressing hard their demands for more and better goods from Eastern Europe and investment in Soviet resource development in return for supplies of energy and raw materials. The East Europeans must anticipate paying more in terms of real outlays just to maintain the current flow of resources from the USSR. The East European economies may well have to undergo major adjustments to meet Soviet requirements, possibly constraining further their capacity for trade with the West.

Tax Policy and Electronics Industry Competitiveness [1] [redacted] 25X1

To compete more effectively with the US electronics industry, the United States' major trading partners over the past decade have turned to favorable tax treatment—among other measures—as a substitute for formal trade protection. The electronics industries in Japan, France, West Germany, and the Netherlands have been major beneficiaries. Recent and proposed tax charges in Japan and Western Europe could further enhance the ability of their electronics industries to maintain high levels of capital and R&D investment. [redacted]

Taxation and the Electronics Industry

The impact of taxes on competitiveness in the electronics industry is largely a function of the industry's ability to take advantage of favorable tax treatment of research and development (R&D) expenditures and short-lived capital equipment. Major provisions include accelerated depreciation, investment and R&D tax credits, and treatment of export earnings, together with the relative importance of debt financing capital within the sector. [redacted]

Most major countries have adopted a number of measures that reduce the corporate tax burden on their electronics firms. Although current provisions under the US tax code give US firms substantial investment and R&D incentives, foreign countries provide similar or even better treatment. In particular:

- France exempts nearly all foreign income and provides lucrative R&D tax credits and substantial depreciation allowances.
- West German firms rely on special or accelerated depreciation allowances to offset high nominal tax rates. In addition, West Germany is the only major country to totally eliminate the double taxation of corporate income.
- The Netherlands exempts virtually all foreign business income and provides deductions for foreign taxes paid on investment income, significantly reducing taxes for its internationally oriented companies. 25X1
- Japanese electronics firms rely on accelerated depreciation practices that, until the 1981 US tax reform, were more favorable than those granted to US electronics firms. [redacted] 25X1

Because interest payments on corporate debt are an important tax writeoff, we believe the single greatest tax advantage that foreign firms have comes through their extensive use of debt financing. Electronics firms in Japan, France, West Germany, and the Netherlands operate with debt-to-equity ratios two to five times those of comparable US firms. As a result of long-term relationships with large banks, electronics firms in Japan, the Netherlands, and West Germany have relatively easy access to loans, while the major electronics firms in France have been nationalized. As a result, foreign firms are able to write off a larger share of their financial capital costs. [redacted] 25X1 25X1

More liberal national accounting principles may also provide advantages for foreign firms. Corporate accounting practices in France, Japan, and West Germany are geared toward minimizing tax payments. Consequently, the reported earnings of their firms are generally lower than those of a comparable US firm. Moreover, Dutch use of replacement cost accounting has the same effect. Unless adjustments are made for these accounting differences, tax payments as a share of income for foreign firms will appear higher than those of US firms. [redacted] 25X1

[1] This article summarizes a forthcoming Research Paper. [redacted]

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Measures and Factors Affecting Corporate Tax Burden: Expected Difference From US Standards[a]

● Relatively insignificant advantage/disadvantage

● Provides significant disadvantage

◎ Provides significant advantage

	France	Netherlands	West Germany	Japan
Nominal tax rate	●	●	●	●
Depreciation	[illegible]	●	[illegible]	[illegible]
R&D incentives	●	●	[illegible]	●
Investment credits	●	●	●	●
Special provision	●	●	●	●
Foreign earnings	[illegible]	[illegible]	●	●
Financial structure	[illegible]	[illegible]	●	[illegible]
Accounting environment	[illegible]	[illegible]	●	●
Overall	[illegible]	[illegible]	[illegible]	●

[a] Judgments presented in this chart pertain to individual country differences in the electronics industry with the United States and should not be used for cross-national comparisons with reference to individual line items.

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Moreover, French, German, and Japanese accounting practices can give their firms an absolute tax advantage. For example, firms in these countries have greater flexibility in establishing liabilities, reserves, and provisions for expected future cash outlays than their US competitors, and this reduces taxes as well as reported profits. [redacted] most tax experts believe that foreign firms have greater latitude in manipulating transfer prices to shift profits from high- to low-tax jurisdictions. [redacted]

Actual Tax Burdens

After accounting for the tax advantage of debt finance and adjusting to ensure the comparability of earnings, we find that the average tax burden on the major European electronics firms studied is roughly one-third the level of those for their US and Japanese counterparts. An alternate measure of tax burdens, the ratio of taxes to sales, further demonstrates that tax systems that at first glance appear highly favorable for US firms are actually comparable or less advantageous. Although the tax burden on Siemens—the largest and most diversified German electronics company—is lower than that of IBM and Hewlett-Packard, it is higher than the tax burden of more specialized US companies. As a result of the 1981 tax reductions for US corporations, the average tax burden on these firms declined from 41 to 35 percent. [redacted]

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Outlook and Implications

Recent and proposed tax changes being considered by Japan and European countries that could fur-

Measuring the Tax Burden—Company Data, Averages for 1979-83 [a]

Percent

Company	Nominal Tax Rate [b]	Net Credits [c]	Burden Per Annual Report	Differences From US GAAP [d]	Deferrals [e]	Depreciation [f]	Effective Tax Rate	Interest Adjustments [g]	Tax Burden	Taxes as Share of Sales [h]
France [i]										
CII Honeywell-Bull	50.0	NM	NM	NM	NM	NM	NM	NM	10.8	0.4
Thomson	50.0	NM	NM	NM		NM	NM	NM	10.3	0.4
West Germany										
Nixdorf	NA	NA	36.2	0		(7.5)	28.7	(15.3)	13.4	1.7
Siemens	63.8	(2.9)	60.9	(2.1)		(13.4)	45.4	(13.9)	31.5	2.7
Netherlands										
Philips	48.0	(15.8)	32.2	(6.9)		0	25.3	(15.0)	10.3	0.7
Japan [j]	**55.5**	**(0.7)**	**54.8**	**NEGL**	**0**	**(5.1)**	**49.7**	**(12.1)**	**37.6**	**3.8**
Fijitsu	56.0	(0.1)	55.9	0.7	0	(10.0)	46.6	(7.2)	39.4	4.6
Hitachi	55.0	(3.4)	51.6	0	0	(4.4)	47.2	(9.9)	37.3	4.1
Matsushita	56.0	(2.4)	53.6	0	0	(4.8)	48.8	(5.2)	43.6	4.9
Mitsubishi	56.0	(1.1)	54.9	0	0	(5.2)	49.7	(16.3)	33.4	2.8
NEC	55.0	1.5	56.5	0	0	(5.2)	51.3	(22.3)	29.0	2.4
Toshiba	55.3	4.9	60.2	0	0	(4.9)	55.3	(20.2)	35.1	2.9
United States [j]	**47.5**	**(4.7)**	**42.9**	**0**	**(2.2)**	**(0.8)**	**39.8**	**(2.1)**	**37.7**	**8.9 [k]**
Hewlett-Packard	48.7	(3.2)	45.6	0	(6.6)	0	38.9	(2.3)	36.6	7.4
IBM	47.5	(2.9)	44.7	0	(2.1)	0	42.5	(1.8)	40.7	10.6
Motorola	48.0	(19.3)	28.6	0	(1.3)	0	27.4	(4.3)	23.1	2.3
Texas Instruments	46.0	(6.5)	39.6	0	0.5	(8.4)	31.6	(2.7)	28.9	2.9

[a] Data for CII Honeywell-Bull are for 1979-81; for Nixdorf, 1981-83; for Texas Instruments, 1979-82; for Thomson, 1983 only.
[b] Reflects national, state, and local income taxation.
[c] Credit adjustment includes tax credits for R&D, investment, earnings distributed as dividends, and the effect of lower taxation on foreign earnings, net of tax on nondeductible expenses.
[d] Differences from US generally accepted accounting practices (GAAP) are only those that are quantifiable from financial statements.
[e] Adjustment for deferral is based on the increase (decrease) in current tax liability as reported in the statement of changes in financial position. Tax deferrals in the United States result largely from depreciation for tax purposes at rates higher than those reported for financial statement purposes. The adjustment for Japan is net of allowances for severance liabilities in excess of those allowed for tax purposes. Depreciation for tax and financial purposes is generally identical in Japan. Deferred tax liability is not generally recognized in France and West Germany. (Bull, which reports according to US GAAP, is an exception.) The adjustment for Philips is included under differences from US GAAP.
[f] The adjustment for depreciation is, in the case of Japan and France, the excess amount claimed by those companies over what a comparable US company would charge. In the case of Germany, the adjustment is for special depreciation over and above normal depreciation as reported in financial statements. The depreciation adjustment for the Netherlands is included under differences from US GAAP because it results from replacement cost accounting.
[g] Interest adjustment is based on interest expense as reported in company financial statements.
[h] Reported tax expense as a percent of sales.
[i] Due to reported losses in some years, intermediate results are not meaningful (NM).
[j] Weighted average of electronics firms studied.
[k] Weighted average without IBM is 4.1 percent. Post-1981 tax burden measures are significantly higher than those for pre-1981 because of the twin effects of US tax measures and the poor performance of US semiconductor manufacturers in 1981-82:

	Taxes/Sales		Tax Burden	
	1979-80	1981-83	1979-80	1981-83
Hewlett-Packard	8.3	6.9	45.5	30.7
IBM	10.6	10.7	42.0	39.9
Motorola	3.4	1.6	28.6	19.4
Texas Instruments	4.2	1.6	38.7	19.3
Weighted average	**9.2**	**8.7**	**40.8**	**35.3**

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Taxation and the Japanese Electronics Industry

Throughout the 1960s and 1970s, Japan used a broad range of tax measures to foster investment and stimulate demand in the electronics industry. In addition to R&D tax credits, special depreciation for R&D–related investments, and tax credits for small businesses purchasing electronics equipment, a number of tax-free reserves were established to provide tax deferral benefits. The most important of these reserves have been the Computer Software Development Reserve and the Electronic Computer Repurchase Loss Reserve—two programs designed to help Japanese firms compete with US computer and software firms, particularly IBM. [redacted]

More recently, budgetary pressures as well as the international success of their major industries, have lead Tokyo to raise nominal tax rates and reduce a number of tax incentives. The electronics industry, however, has been relatively successful in fending off adverse tax policies. High-technology firms seem assured of an increase in the R&D tax credit, and concerted lobbying caused the government to withdraw a proposed commodity tax on computers and office automation equipment. [redacted]

ther impact on competition in the global marketplace include:

- A Japanese tax package that encourages R&D spending by offsetting a general increase in nominal tax rates with an additional 7-percent credit for basic R&D and the development of new communications systems.

[redacted]

- A 1984 West German tax revision allows for a 40-percent writeoff for R&D investments. Bonn is also studying a number of tax incentive programs designed to enhance venture capital markets.

- The Netherlands, although not currently considering additional tax measures, reduced nominal corporate tax rates from 48 to 43 percent and replaced its complex tax credit system with a general 12-percent investment tax credit in 1984.

These tax policies could help foreign electronics companies in their competition with US firms for global markets. Although taxes are only one determinant of competitiveness, these changes would increase their firms' abilities to maintain high levels of capital spending and R&D funding [redacted]

[redacted]

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Syria: Living on Aid

Syria's economy is in terrible shape. Real GDP has declined over the past three years, foreign exchange reserves are practically nonexistent, and the current account has been in deficit for the last five years. Defense eats up 55 percent of current expenditures. The economy suffers from incompetent managers, corrupt officials, and the malaise and inefficiency of a centrally planned system.

Syria is surviving on foreign aid. The Arab states are providing the bulk of the financial aid, Iran supplies most of Syria's oil imports, and the Soviet Union delivers military equipment and training under easy, long-term credits. Recent oil discoveries could produce enough oil in two or three years to displace almost all of Syria's current oil imports but will not eliminate the need for foreign aid to cover current account deficits.

Three Years of Economic Decline

Contrary to official Syrian statistics, Syria likely has been experiencing at least three years of economic decline. Damascus claims that GDP grew at just over 3 percent per year in real terms in 1982 and 1983 and will likely report real growth of between zero and 2 percent in 1984. Real GDP, however, may have declined as much as 10 to 15 percent last year. With one of the highest population growth rates in the Middle East, estimated at 3.7 percent per year, the GDP decline has been even larger on a per capita basis.

The reason for this discrepancy is a comprehensive system of price controls and government subsidies for several essential goods and services that understate the official inflation rate. Press and Embassy reports indicate that actual price rises, often reflected in the black-market price of goods and foreign exchange, were at least 10 to 20 percentage points greater than the official rate during the past three years.

Chronic Balance-of-Payments Deficits

In the last five years, Syria's current account deficit has averaged almost $1.9 billion per year for its civilian sector alone. If military imports were added, the average annual current account deficit would almost double. Military imports are financed under generous long-term loans by the Soviet Union, but the civilian deficit has been financed by aid from other Arab countries and by a buildup of Syrian foreign currency debts. Exports of crude oil and refined products, three-fourths of total Syrian exports, have been hurt by falling oil prices in the past few years and stagnant production in Syria's northeast oil fields. Moreover, poor agricultural output last year reduced Syria's exports of cotton, barley, and other food products and forced Syria to import food, including a record 1.4-1.5 million metric tons of wheat.

An Unhealthy Balance Sheet

Syria last published its official foreign exchange position in the third quarter of 1983 when it listed $74 million in foreign exchange holdings. We estimate that, with some fluctuations, Syria has probably maintained that level, equal to about eight days' worth of civilian imports. We believe President Assad also controls a foreign exchange account of perhaps $100 million that he can call on in emergency situations. Damascus also retains gold holdings, worth about $260 million.

Syrian officials point with pride, unjustifiably so, to Syria's relatively small hard currency debt. Disbursed civilian hard currency debt is reported to total about $3.0 billion, the bulk of which is on concessionary terms. This figure, however, probably does not include Syria's oil debts to Iran, which

Syria: Balance of Payments,[a] 1980-84

Million US $

	1980	1981	1982	1983	1984 [b]
Trade balance	−1,898	−2,458	−1,566	−2,115	−1,700
Exports (f.o.b.)	2,112	2,097	1,903	1,845	1,950
Crude oil	1,334	1,209	974	1,004	NA
Imports (f.o.b.)	4,010	4,555	3,469	3,960	3,650
Services, net	−399	−259	−362	−314	−300
Private transfers	137	547	418	440	400
Current account	−2,160	−2,170	−1,510	−1,989	−1,600
Official transfers	1,520	1,711	1,292	1,217	1,000
Other capital	−32	128	20	359	NA
Errors and omissions	−25	−15	−32	49	NA
Overall balance	**−697**	**−346**	**−230**	**−364**	NA

[a] Excludes military transactions.
[b] Estimated.

[redacted] 25X1

may total as much as $1.5-1.7 billion, and certainly does not include its very large military debts to the Soviet Union [redacted]

Arab Financial Aid

Syria has coped over the past few years through President Assad's adroit manipulation of the Middle East political situation to extract aid from an incongruous mix of donors. Despite ties with Iran, Syria's main sources of financial aid have been other Arab states. Arab financial aid to Syria peaked in 1981 at about $1.8 billion and has declined every year since then. Financial aid probably totaled $900 million to $1 billion in 1984 and covered approximately 60 percent of Syria's estimated civilian current account deficit. It appears that Arab aid payments will fall again this year, probably declining to about $800 million. Under the Baghdad Agreement of 1978, Syria was to have received $1.85 billion a year for 10 years. Libya and Algeria, however, have never paid, and Iraq stopped payments when Syria allied itself with Iran in 1982. Oil revenue declines caused Qatar, Kuwait, and the UAE to suspend payments in 1982-83. Saudi Arabia has been the only country to keep up its payments. In addition to its Baghdad commitments of $530 million, Saudi Arabia has made other payments to Syria totaling as much as $300 million in 1981 and 1983, and as little as $100 million in 1982 and 1984. [redacted] 25X1

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Kuwait resumed its Baghdad payments to Syria last September at 60 percent of their former level. The second of three Kuwaiti installments of $58 million was made in January, but, because of Kuwait's drop in oil revenue and its relationship with Iraq, Kuwait may discontinue these payments or again cut back on the amount. [redacted] 25X1

Oil Aid From Iran

In the 12 months following the closing of the Iraq-Syria oil pipeline in April 1982, Iran provided Syria

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with over 50 million barrels of oil; 7 million barrels free, and almost all of the rest at discounted prices. When Syria failed to pay nearly $1 billion in oil debts accumulated under that agreement, Iran ultimately forgave the debt. [redacted]

Under the 1983/84 and 1984/85 contracts, Iran provided annually 7 million barrels of oil free of charge and 36 million barrels at a $2.50 per barrel discount. The free oil plus the discount cost Tehran about $300 million per year in direct aid. Syria, however, again failed to pay its oil debts during the 1983/84 contract period, and nearly $1 billion in Syrian oil debts were converted into interest-free loans. Syria is once more behind on its oil payments for last year's contract with no settlement in sight. A new contract has now been signed, but the debt problem hangs over the relationship and the new agreement may face some problems in Iran's Consultative Assembly. Iran is likely to proceed with this year's agreement but may delay shipments—as they have done in the past—as a sign of their displeasure. [redacted]

Syrian delaying tactics probably pushed Iranian aid in dollar terms to about $1.3 billion in 1982 and 1983. Last year, the Iranians appeared to hold the Syrians more in line and aid in dollar terms—that is, the free oil, the discount, and delayed payments—may total between $600 and $700 million. [redacted]

Prospects Brighten on the Oil Front

Syrian economic prospects have brightened somewhat over the last year as further development work has confirmed a major—by Syrian standards—new oilfield near Dar az Zawr, in eastern Syria. Oil being produced at the new Thayyem field is light and low in sulfur content, similar to the oil Syria is now importing. Although this field is not yet fully delineated, the initial discovery wells tested at about 6,000 b/d. [redacted]

A second oilfield, called Ash-Shola, was discovered west of the Thayyem field in March of this year. The oil is reported to be similar in quality to that in the Thayyem field. No flow rates or estimates of the field's potential have been reported. [redacted] 25X1

Production in the new fields earlier this year was averaging about 5,000 b/d and was scheduled to increase to as much as 10,000 b/d by 1 May as the logistics of trucking the oil were worked out. Once the spur pipeline connecting the Thayyem field to the Iraq-Syria pipeline is completed, production is expected to increase to 60,000 b/d. Depending on the pace of field development, production [redacted] is forecast to average over 100,000 b/d by 1988. [redacted] 25X1 25X1 25X1 25X1

The new fields have the potential to displace most Syrian oil imports within two to three years. This would free Damascus from its dependence on Iran, but Syria will have to share its new oil wealth with its foreign partners. [redacted] At a 100,000-b/d production level, Syria would have to come up with as much as $480 million a year for its partners or lose over half the oil to exports. Syria would still need at least $500 million in aid to cover its civilian, nonoil current account deficit. [redacted] 25X1 25X1 25X1 25X1 25X1

Outlook

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Despite new oil discoveries, Syria faces a two- to three-year period of increased economic vulnerability. Damascus must still cope with an economic recession, large balance-of-payments deficits, and continued heavy defense expenditures. Syria will continue to need outside aid even when oil imports decline. Arab financial aid is declining, however, and, although Saudi Arabia is likely to continue its payments, Kuwait may once again lower or stop its aid. In addition, Syria's profitable political and economic relationship with Iran could end. Iran, with its own financial problems, is becoming increasingly fed up with Syria's delaying tactics on oil payments. Syrian-Iranian differences over Iranian and Hizballah activity in Lebanon are likely to 25X1 grow. If the Iran-Iraq war were to end, Assad's ability to extract money from Iran for Syrian support would be reduced. [redacted] 25X1

Syria's economic decline and aid dependency, however, will not cause it to modify its policies at home or abroad. President Assad has demonstrated an ability to take advantage of changing political circumstances to squeeze financial aid from other states. In addition, he will be looking ahead to exploitation of Syria's newfound oil reserves and is unlikely to moderate his policies for what he probably perceives as a temporary hardship. [redacted] 25X1

[redacted] 25X1

LDC Banking Crises: A Threat to Economic Adjustment [redacted] 25X1

Argentina and Brazil lead a growing list of developing countries that have begun to suffer failures of overextended private banks. As a result of recession and economic austerity, earlier imprudent loans are weakening LDC bank loan portfolios. In turn, liquidity crunches have led to insolvency when rumors of financial problems have produced depositor runs on these banks. Moreover, poor management of financial institutions and even blatant corruption have made failure in some cases almost inevitable. These events are helping to undermine public confidence in LDC domestic financial institutions—and, in governments' supervision of them—which could lead to popular unrest. Moreover, bank bailouts can threaten compliance with IMF programs and jeopardize flows of international lending. [redacted]

Factors Behind the Emerging Bank Failures

The major causes of bank failure in LDCs include overextension of bank lending—in some cases associated with high-level corruption by bankers and government officials—and government mishandling of financial sector reforms or banking crises. [redacted]

Argentina. In late March the Argentine Government made a number of credit-tightening moves, including sharp reductions in deposit guarantees that reintroduced a degree of risk into the Argentine banking system. In April two sizable, well-established financial institutions and five smaller banks failed; five of these failures were attributed to the new regulations. On 10 May the central bank announced liquidation of the Banco de Italia, the country's 11th-largest bank that set off a run on the dollar accounts in many private banks. The Central Bank last week froze all dollar accounts for 120 days in a move to protect the financial system. [redacted]

According to the Embassy, the Central Bank's handling of this situation has diminished public confidence in the financial system at a critical time in Argentina's economic history. [redacted] 25X1
[redacted] some foreign creditors are increasingly concerned about Argentine economic management and say they will withhold participation in Argentina's pending new loan package until the failed bank's foreign debts are honored. 25X1
[redacted] 25X1

Brazil. The new government also continues to struggle with repercussions from the earlier collapse of three important financial institutions. Reportedly serious irregularities on the part of the directors of the Brasilinvest bank and brokerage firm prompted the Central Bank to announce liquidation of the Brasilinvest Group on 18 March. 25X1 The next week the government reversed its earlier stand by announcing a $200 million purchase of stock in Sulbrasileiro and Habitasul and injected a roughly equal amount into two other failing banks. Facing threat of violent action by these banks' 20,000 employees—fearing job losses—the government may hire many of them for the new state bank that will replace these institutions. 25X1 [redacted] 25X1

Ecuador. On 8 May, Ecuador's fifth-largest commercial bank, the Guayaquil-based Banco de Descuento, was declared insolvent, and the country's superintendent general of banks and a Guayaquil subordinate were charged with knowingly permitting that bank's illegal lending practices to continue. The US Embassy reports that recent rumors concerning the bank's condition prompted panic withdrawals of $10 million during the two weeks before to the government's intervention. In a nationally televised speech, President Febres-Cordero guaranteed full refunds of checking and savings accounts to all depositors. With the additional

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disclosure of financial mismanagement in two other medium-sized Guayaquil banks, the US Consulate reports increasing public concern. [redacted]

Kenya. US Embassy reporting indicates that the Continental Bank of Kenya is facing serious financial difficulties. Amid allegations of these and other serious financial improprieties, it could be forced to close its doors, threatening a ripple effect throughout the Kenyan financial community. Continental, opened in 1983, cannot pay its heavy debts to a government-owned bank. Other local banks are reluctant to join Central Bank efforts to bail out Continental, and the Embassy believes that a crisis is looming. This comes just five months after the central bank suspended operations of the much smaller Rural-Urban Credit Finance, one of four or five other financial institutions that are dangerously overextended. The Embassy reports that Kenya's capital market is too thin to support the several new banks that have opened in the past year and that several US banks are reexamining the rationale for their presence in Nairobi. [redacted]

Liberia. According to the US Embassy, the nearly bankrupt National Housing and Savings Bank experienced a modest run earlier this month. It is overdue in repaying loans to other banks, and the Embassy believes its closure could be imminent. The Agricultural Bank and the smaller Italian-owned Tradevco Bank are not much stronger. According to the Embassy, closure of one or more of these banks could increase pressures on other banks and the Central Bank. [redacted]

Peru. The US Embassy reports that 13 Peruvian banks had each accumulated unpaid overdue loan balances equal to 50 percent or more of their capital stock as of last November. For the largest bank, overdue debts exceeded 125 percent of its capital stock and for the second largest nearly 600 percent. Should runs occur on any of these banks, the Embassy reports that this could derail the ongoing austerity plan and significantly undermine the new administration's economic plan by shattering savers' confidence. Thereafter, the Embassy fears that dollar capital flight could take on dramatic proportions, thus exacerbating both the shortage of investment funds and unemployment. [redacted] 25X1 25X1

The Philippines. In March, Banco Filipino was liquidated. Over half of the bank's largely nonperforming loan portfolio was in corporations linked to the bank officials. Because Banco Filipino accounts for approximately 40 percent of the assets of all thrift banks, this episode has undoubtedly undermined confidence in the Philippine banking system and the Central Bank's management of financial policy. [redacted] 25X1

Taiwan. The recent collapse of the Tenth Cooperative Bank constitutes the largest financial crisis in Taiwan's history. Press reports indicate that bank officers had diverted large amounts of funds to Tsai enterprises. The family's Cathay Investment and Trust Company, the largest trust company in Taiwan, was also taken over by the government in the spreading scandal that involved the resignation of the Economics Minister and the arrest of the head of the Tenth Cooperative Bank and 12 of its officials. According to the US Embassy, these developments symbolize the serious problems inherent in Taiwan's financial system, and, unless changes are made in the basic structure of the system, further negative effects for the economy are likely [redacted] 25X1 25X1

The United Arab Emirates. In April the US Embassy reported that a bank owned by the Dubayy government would absorb the financially troubled Dubayy Bank, formerly owned by a local investment group with minority participation by an American and Swiss bank. Lending to the local owners' other business interests—particularly real estate in Singapore—caused the bank's liquidity crisis. The Embassy cites informed estimates that the Dubayy government would have to inject about $280 million into its own bank to cover the liabilities of the dissolved Dubayy bank. In the short 25X1

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term, international banks will look much more closely before lending in the market, and UAE firms will face higher borrowing costs. [redacted] 25X1

Potential Fallout

We believe that the incidence, visibility, and economic importance of Third World bank failures will continue to grow. The realities of financial reform in most developing countries suggest that meaningful changes in financial policy or bank regulations cannot be made quickly enough. Moreover, without rapid and sustained economic recovery, it is unlikely that nonperforming loans will become viable assets again. [redacted] 25X1

In most developing nations, the specter of bank failure raises a policy dilemma. International debt negotiations in conjunction with economic recovery programs are jeopardized if failing institutions are rescued by the Central Bank, while the interests of depositors, domestic creditors, and bank employees are threatened if they are not. We believe that increasing domestic financial crises will cause growing concerns for international lenders and donors if bank bailouts jeopardize IMF programs. In particular, increased government spending or central bank support would undercut compliance with budget deficit, monetary growth, or, ultimately, inflation targets. Moreover, diminished public confidence in the domestic financial system could be a contributing factor to economic or even political instability. Such developments could cause international banks to consider further reducing their already-limited exposure in the Third World. This would complicate still more the international debt rescheduling process and perhaps stifle economic recovery in the affected Third World nations. [redacted] 25X1

[redacted]

25X1

Briefs

Energy

Swiss-Dutch Natural Gas Contract Renewal

[redacted]

The Dutch state firm Gasunie has agreed to a 10-year renewal of its contract with Swissgas to supply 500 million cubic meters of natural gas annually in 1995-2004. The Dutch are in the process of negotiating extensions with many customers on contracts due to expire in the early 1990s. Gasunie currently supplies nearly 40 percent of Swissgas requirements. In 1988, however, Switzerland will start receiving up to 650 million cubic meters annually of 25X1
Soviet gas via an agreement with West Germany's Ruhrgas. Gas accounted for over 7 percent of Swiss energy usage in 1984 and is expected to rise to about 10 percent by 1990. [redacted]

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West European–Norwegian Gas Contract Renegotiations

[redacted]

West European natural gas buyers have asked Norway's Statoil to renegotiate their contracts for gas from Norway's Statfjord field. They have invoked the hardship clause that allows price renegotiation if purchasers believe they cannot sell Statfjord gas profitably. The original 1981 price was $5.50 per million Btu, with deliveries to begin 1 October 1985. While clauses linked to oil prices have since reduced that price to about $4.65 per million Btu, continental buyers point out that other West European gas supplies—including 25X1
recent Soviet contracts—are nearly $1.00 per million Btu cheaper, and Western Europe is currently experiencing excess supplies of natural gas.
[redacted] Statoil may be unwilling to accept 25X1
any price below $4.00 per million Btu. In addition to price, deliveries of up to 3.4 billion cubic meters per year at peak production may also be revised downward. Negotiations are expected to be arduous lasting through the third quarter of 1985. [redacted]

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Algerian-Brazilian Natural Gas Contract

[redacted]

[redacted] Algiers has initialed a barter agreement with 25X1
Companhia Energetica de Sao Paulo (CESPA) to deliver about 1 billion cubic meters per year of liquefied natural gas (LNG) for five years to the port of Santos beginning in late 1985 or early 1986. CESPA is expected to arrange for offsetting sales of railway technology and equipment as well as construction and engineering services. Brazil currently consumes about 2.5 billion cubic 25X1
meters of gas—less than 2 percent of its total energy requirements. Although the agreement marks a significant geographic expansion in Algerian LNG marketing efforts, there is no chance that deliveries will occur as early as planned because a regasification facility must first be built at Santos. [redacted]

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International Finance

German Bank Attitudes on LDC Debt [redacted]

[redacted] the major West German banks are in general agreement regarding long-term solutions to the LDC debt problem. The largest banks recently agreed that once multiyear reschedulings are completed for the major debtors and compromises—involving some rescheduling and some writeoffs—are reached with smaller debtors, the LDC debt problem will move out of its current second phase. [redacted] These banks favor a greater role for the World Bank during this next phase, including an expansion of the IBRD's structural adjustment lending program and greater cofinancing arrangements between the IBRD and commercial banks. [redacted] 25X1 25X1 25X1 25X1 25X1 25X1

Saudi Arabia Covering Somalia's Debts [redacted]

The US Embassy in Riyadh says the Saudi Government has paid the Saudi Fund for Development $16.5 million owed by Somalia—the first time in the Fund's 10-year history that Riyadh has paid off the debts of any of the 56 loan recipients. The Fund suspended dispersals for 14 countries, including Somalia, on 15 April for failure to repay principal or interest on existing loans. Riyadh's action now releases more than $25 million in project aid to Mogadishu. The move probably reflects Riyadh's concern over Somalia's stability, particularly following the coup in Sudan; the Saudis might also be attempting to counter recent Libyan political overtures. If the payment becomes known, other debtors—including Sudan and Syria—may press for similar treatment. Riyadh's budget deficit, however, will prevent it from accommodating many such requests. [redacted] 25X1 25X1

Bangladesh Seeking IMF Loan [redacted]

Bangladesh is seeking $150 million in loans from the IMF because of a major deterioration in its foreign exchange reserves. Debt service payments, declining worker remittances, and food imports prompted by last year's floods have reduced foreign exchange reserves to $360 million from $520 million a year ago. US Embassy sources report that World Bank approval of $130 million in import credits is dependent on approval of the IMF loan. Dhaka is prepared to devalue its currency by 15 percent by yearend and maintain high interest rates to curb domestic credit to comply with IMF-supported economic adjustments, according to the US Embassy. Bangladesh needs these loans to maintain essential imports, but the attendant austerity conditions are likely to increase domestic discontent at a time when the martial law regime is trying to set the stage for national elections. [redacted] 25X1 25X1

Global and Regional Developments

Poland Gives Nicaragua Merchant Vessel [redacted]

Poland has given Nicaragua a merchant ship, probably as a gesture of support to help counter the US trade embargo. The ship, Wladyslaw Broniewski, built in 1963, has a cargo capacity of 10,526 tons. Nicaragua owns one other oceangoing ship, the Monimbo, and several small coastal freighters. Although

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Nicaragua claims the Polish vessel is to be used to ship bananas to Europe, we have seen no agreements to substantiate this. It is possible that the ship may also be used to transport arms. The reliability of the vessel is questionable, given its age and the fact that the Nicaraguans have a poor record of maintaining their fleet. The Monimbo, which is 11 years newer, has been plagued by mechanical problems because of poor maintenance and an inability to pay for spare parts. [redacted] 25X1

National Developments

25X6

Developed Countries

25X6

[redacted]

[redacted]

Tough New Canadian Budget

[redacted]

Canadian Finance Minister Wilson's austere budget, announced last week, is meant to cut the deficit and restore business confidence, but will hurt the Tories if private-sector-led growth does not reduce the current 10.9-percent unemployment rate significantly. Expenditures are to be cut across the board. Tax levies include a 1-percent increase in the general sales tax and higher payments by middle- and upper-income Canadians. Income tax schedules will be partially deindexed. The Tories' first budget will be judged on its ability to lower nominal interest rates and unemployment. By lowering the deficit by an additional US $1.6 billion, the budget should strengthen the Canadian dollar and permit some reduction in interest rates. Lower interest rates will also reduce interest payments on the federal debt—one of the most rapidly growing government outlays. Ottawa hopes to create jobs by rewarding efficient producers. The budget, for example, substitutes tax incentives for direct subsidies. Likewise, the partial deindexation of income taxes, although aimed mainly at raising revenue, may also prompt workers to try to boost their incomes in 1985—through longer hours and part-time jobs—before taxes rise next year. By putting the onus for reducing unemployment on the private sector, Mulroney risks a rapid decline in Conservative popularity if the economy fails to respond. [redacted] 25X1

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British Inflation Worsens

[redacted]

British consumer price inflation accelerated unexpectedly in April, recording a 12-month increase of 6.9 percent—the highest rate since October 1982 and up from 4.5 percent in December. Higher import costs, rising mortgage rates, and recent large wage settlements led to the jump. In addition, the M3 measure of money has increased at a 15.5-percent annual rate over the last six months, fueling expectations that inflation will temporarily rise even higher. This is unpleasant news for Prime Minister Thatcher whose policy has aimed at 25X1 keeping inflation low as one means of achieving sustained economic growth. Faced with increasing criticism from within her own party for failure to reduce unemployment—13.1 percent and rising—she now will almost certainly face charges that her anti-inflationary policies are also failing. [redacted] 25X1

United Kingdom Boosts Export Insurance Rates

[redacted]

The Exports Credits Guarantee Department (ECGD), which insures about one-third of British exports, is boosting its premiums as of 1 July. Although premiums for low-risk markets will not be increased, hikes of 10 to 15 percent will apply to countries that have recently rescheduled their debts, or that are deemed as high political risk areas. The ECGD blames the move on the sharp climb in claims—up 24 percent to an estimated $1.1 billion for the 1984/85 fiscal year. It is in line with the Thatcher administration's penchant for cutting 25X1 costs and eliminating loss-making services. The new rate structure will probably have only a marginal impact on exporters' willingness to do business in high-risk markets. [redacted] 25X1

French Unemployment Eases Temporarily

[redacted]

Seasonally adjusted French unemployment edged down in April for the third straight month, reducing the number of jobless by nearly 40,000 below the January level. Part of the fall probably is because of a public works jobs program for youth and continued government-sponsored retraining for the unemployed that keeps them off the unemployment rolls. The improvement is likely to be short lived, however, as the Statistical Institute recently forecast a 25X1 10-percent rise in the number of unemployed this year—boosting the rate to nearly 11.5 percent. Meanwhile, the opposition has indicated that it will publish "true unemployment" figures that correct for make-work schemes, retraining programs, and early retirement to capitalize on the issue before the National Assembly elections next spring. The Socialists are likely to counter that the opposition also disguised unemployment with "youth employment pacts" and early retirement when it was in power. [redacted] 25X1

Less Developed Countries

Tunisian-Airbus Negotiations

[redacted]

Tunis has reached tentative agreement with Airbus Industrie to aquire eight A320 aircraft [redacted] The aircraft will replace 25X1 Tunisia's aging fleet of Boeing 727s that will be used as partial payment under terms of the agreement. Delivery could begin as early as 1986. The deal, if finalized, may be signed during President Bourguiba's planned mid-June visit to Paris. The sale would be a major breakthrough for Airbus in the North

African market previously dominated by US manufacturers. A successful sale also may prompt Algeria and Morocco to consider Airbus aircraft as replacements for their aging US-origin fleets. 25X1

Libyan Airline Problems

Libyan Arab Airlines (LAA) reportedly is under pressure to acquire spare parts for its Boeing fleet. Over $90 million has been budgeted for spare parts this year. LAA may turn to other Third World airlines because attempts to circumvent US trade restrictions by procuring parts from European airlines or through links with organized crime have so far been unsuccessful. These increased efforts probably will not provide sufficient replacement parts to prevent further deterioration of the Libyan Boeing fleet. Many vital parts are manufactured for a specific engine, making it difficult to disguise the final end user.

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Zimbabwe Foreign Exchange Decisions

Zimbabwe has announced plans to increase foreign exchange allocations to industries this year and reinstate dividend and profit remittances in 1986, according to US Embassy reporting. Finance Ministry officials expect the 30-percent increase in foreign currency allocations to boost badly needed imports of industrial materials to aid economic recovery. Dividend and profit remittances, suspended last year because of Zimbabwe's deteriorating foreign payments position, will be released in annual installments over a six-year period. Meanwhile, Harare is planning to meet with IMF officials this week to discuss targets for a new IMF agreement to replace the one suspended in March of 1984. Both foreign currency decisions should facilitate negotiations.

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Mozambique Announces Agricultural Reforms

Maputo has increased incentives and support for private farmers to revitalize agriculture, according to US Embassy reporting. The new measures—the latest in an economic liberalization program launched in 1983—include removal of price controls on some staple crops and higher prices for others. So far, the government has increased the producer price for corn and wheat by 100 percent. In addition, the reforms call for channeling financial aid—primarily from Western sources—to help private farmers acquire seed, equipment, training, and advisory services. Maputo's previous policies had stressed state agricultural operations at the expense of private farmers, who produce about three-fourths of Mozambique's agricultural output. These policies contributed to increased peasant support for the insurgency that is now disrupting the country's economy.

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Ghana Launches Gold Production Program

Ghana's Ashanti Goldfields Corporation has launched a major expansion program aimed at increasing gold production by 60 percent over the next five years. The $160 million project focuses on upgrading the Ashanti mine, the largest gold mine outside South Africa and the Soviet Union. Company-retained earnings will provide half the funds with loans from the World Bank's

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International Finance Corporation and a syndicate of commercial banks providing the remainder. Gold currently provides about 15 percent of Ghana's export earnings. At current prices, the additional 160,000 troy ounces of output from Ashanti would increase these revenues by over $50 million per year. [redacted] 25X1

USSR Offers India More Trade and Aid

Two agreements signed during Prime Minister Gandhi's May visit to the Soviet Union reflect Moscow's effort to preserve economic ties in the wake of Gandhi's liberalized economic policies. A $1.15 billion credit, which may include some undisbursed aid, will finance Soviet equipment and services for specific projects in India. Details are not available, but the Indian press reports plans for expanded onshore oil exploration, nearly complete negotiations for a new thermal power plant, and discussions on a nuclear power plant. The shift from heavy industry to fuel and power projects implies that Moscow has acknowledged Gandhi's preference for Western industrial technology. A second agreement provides guidelines for trade and scientific cooperation to the year 2000. Despite these offers, Soviet economic aid will probably continue to play only a minor role in the Indian economy. New Delhi is far more interested in the cheap credit it receives for purchases of Soviet military equipment. [redacted] 25X1

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[redacted]

Possible Thai Purchase of Communications Satellite

Bangkok this month reportedly set up a group to seek private equity financing for up to two-thirds of the cost of the Palapa B-2 satellite, formerly owned by Indonesia. The satellite—rescued by the space shuttle late last year—is currently owned by a consortium of US and British insurance companies. According to Thai press reports, the Communications Ministry hopes to use the Palapa to link an anticipated 250 ground stations in the country to form a telecommunications network. Although rumors of the purchase have sparked a French effort to persuade Bangkok to use the Ariane—the privately operated European space launch vehicle—the rescue contract stipulates that the satellite must be relaunched by the shuttle. [redacted] 25X1

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Communist

Frank Talk on Soviet Economic Policy

General Secretary Gorbachev for the first time has publicly given a target for growth in national income for the 1986-90 Five-Year Plan and has hinted that he supports an increase in the private sector's role to improve the consumer's lot. In a speech to party members in Leningrad last week, Gorbachev stated that the Soviet economy must grow at a minimum of 4 percent a year during 1986-90 to enable Moscow to meet its plans—which he never specified—for investment, defense, and consumption. Although all three claimants presumably could be affected if this target were missed, cuts in planned increases in consumption were the only consequence that Gorbachev mentioned. Gorbachev also called for a "realistic assessment" of the private sector's role in home repairs and other consumer services. The Soviet leader has gone on record with a highly ambitious, and probably unrealizable, growth target almost a year before the new plan is finalized. He apparently is trying to encourage party officials and Soviet workers to carry out the measures outlined at the Central Committee plenum last month. Gorbachev's discussion of the private sector's role in consumer services reflects a willingness—rare for a Soviet leader—to address a contentious issue publicly.

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